JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

II. CLASSES AT THE UNIVERSITY OF WISCONSIN--MADISON

C. Business 526: Property Development and Management

2. Case Study Example: James A. Graaskamp, "Supply and Demand for First Class Downtown Office Space:, February, 1963

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SUPPLY AND DEMAND FOR FIRST CLASS DOWNTOWN OFFICE SPACE

Madison, Wisconsin

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Part B of a two part study of a Madison bank and office building proposal.

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Referenced Tables are missing

CENTRAL OFFICE SPACE

DEMAND - SUPPLY ANALYSIS

The Problem

The following analysis of demand and supply of general office space in the Madison Central Business District (CBD) is directed to the question of the economic feasibility of a substantial increment of such office space which might be provided in the proposed new banking house building for the Madison Bank and Trust Company. The major findings apply regardless of where such a building might be located within the CBD although some locational qualifications are recognized. Data on competitive rents are used to indicate the level of rents which might be secured for new, premium office space.

Method of Analysis

On the supply side of the market, the analysis begins with a detailed current inventory of general office space in the central CBD, defined as the area within a two-block radius of the Capitol Square. The net occupied and vacant areas were tabulated and classified in four quality grades. Current rentals were recorded.

In making projections for future demand for privately-built general office space in the Square area, the year 1970 has been selected as the critical date. It is assumed that any construction of a new bank building could not get under way until 1965 and that it would not be ready for occupancy until early 1967. Thus the important rent-up period would be in the late 1960's and a prediction for 1970 would provide a basis for estimating the probability that

that it could be filled by that time.

To provide an estimate of the supply of office space which will be available in 1970, adjustments were made to the current inventory for increased space use by the owner-organizations of office buildings now partly rented for general use and the consequent reduction in the space available for general purposes by 1970. On the basis of known plans for constructing additional space, the increment to the total supply by 1970 was estimated. Thus, the expected available 1970 supply equals the 1964 inventory less absorption by owner-organizations plus additions through new construction and remodeling.

The primary basis for predicting the demand for CBD office space in 1970 was the employment projections prepared by the Planning Department of the City of Madison as a part of the Madison Transportation Study now in process. These estimates include a forecast of persons in professional employment. On the basis of recent trends, it is predicted that one-half of all professional people in the Madison area will be in central locations in 1970. Space requirements for professional offices can be calculated and on the basis of the expected ratio of professional occupancy to total needs, the total demand for central office space can be determined. No added demand for privately owned office space by the State of Wisconsin is assumed.

With estimates of 1970 available space and 1970 space needs, it is possible to judge how much additional space might be absorbed if the estimates are realized. There is some discussion of the probabilities of such realization and the possible range of error. Consideration is given to the relative desirability of locating new office space in

the present bank location and in recommended locations across the Square. The matter of rental rates is also considered. The possibilities of specialized office space with condominium tenure are suggested.

Supply

The current inventory of general office space in the central area within two blocks of the Square is presented in Table 0-1. This table summarizes a detailed inventory and inspection of all central office space and its classification into four quality grades. The amount of occupied and vacant space in each grade was determined and rental data for all space was collected. In all future discussions, it is assumed that Class D office space is not competitive with newly-built facilities and will likely be retired from the affective market supply by 1970.

Table 0-2 summarizes the changes in the 1964 effective market supply of Class A, B and C general office space in the Square area by 1970. Additions are the result of new construction. Reductions will occur when owner-occupants expand in the use of their buildings and thus remove a part of the effective market offerings of space. Demolitions and conversion to other uses will also decrease the effective supply. The 1964 inventory was 391,600 square feet in Class A, B and C space, including vacant space. Additions of 118,000 square feet (including a rather doubtful item of 40,000 square feet) less deductions of 92,900 square feet indicate a net addition of 25,100 or a total

Footnotes

1. The shape of the present AAA parcel discourages demolition for parking or a new building, yet the location is not undesirable for office space. Therefore we forecast remodeling and improvement of the present structure for a better lobby, elevator and air conditioning with the resulting loss of 500 square feet of rentable space.

2. 20,000 is approximate estimate of planned space from an interview with Mr. Haley, In addition there will be space for a Rennebohm store and cafeteria on the first floor and a private dining club on the top floor.

3. By 1970, First Federal expects to expand into another two-thirds of a floor of rentable area.

4. Commercial State Bank is aggressively seeking redevelopment of its present block to replace its existing building. While its present plans call for an amazing 275,000 square feet of new space on the two triangular blocks bordering the end of State Street, we expect these plans to be scaled to economic realism and to a single block as plottage is now available in the old First Federal S & L building and the YWCA building. Our estimate of 40,000 is rentable area over and above what the bank and Home S & L will require for their own use.

5. Present bank building would be replaced or absorbed into new buildings.

6. A new location for AAA on West Washington has not quite jelled, but it is most probable and AAA reports that building plans call for renting 10,000 square feet in addition to their own space requirements.

7. Wisconsin P & L expects to absorb the remainder of their rentable space for their own operations. Their exact schedule is not certain, but they felt this assumption was reasonable.

8. The Gay Building presently includes its first floor area as rentable office space, although it is vacant. It is our opinion that as retail trade gravitates to the State Street corner of the Square, this first floor space could be converted to retail area.

9. The old Anchor Building will probably be demolished so that the area can be converted to parking space and other uses allied to the Loraine Hotel which reportedly owns the air rights and one of the adjacent lots. It may be used for office space temporarily but should be removed from the market by 1970.

10. The Provident S & L expects to use additional space for its own purposes but declined to estimate how mcuh. We therefore estimated a conservative 700 square feet.

11. Anchor Savings and Loan also expects in the future to expand into space which it is presently hoping to rent for the short term and so we have estimated their additional space needs as a reduction in rentable space by 1970.

12. The Bank of Madison expects to absorb some of its rentable area into its operations but the estimate of how much space is ours.

13. & 14. The First National Building will absorb expansion of bank personnel at the expense of rentable area. In addition, it will secure parking space and additional banking space with demolition of the Washington Building by 1970. While demolition of the Washington Building has been in the rumor stage for years, the bank will be forced to do the job by the competition of drive-in banking and raids on its key tenants.

15. & 16. The National Guardian Life Building expects to offer 28,000 feet in 1965 but expects to absorb another two-thirds of one floor by 1970; hence we have removed some of the space from the market by 1970.

17. The Insurance Building is in strong hands and so we expect that by 1970 it will offer parking on the site of the present Community Center, central air conditioning, and of course, its excellent location.

The Cantwell Building is stabilized by an owner-occupant who should be in a position to remodel the structure to take advantage of adjacent parking and location.

The Tenney Building is in strong hands, and it is our opinion that it will use the site of Fire Station No. 1 and perhaps the Grant Building for a parking ramp. It is presently adding central air conditioning.

supply of 416,700 square feet in 1970. For working purposes, a range of 400,000 square feet to 425,000 square feet is established to indicate the probable order of the existing supply in 1970.

Demand

The next step in the market analysis was a general study of the office space market in the Madison community with a view to determining the role of the central area in the total market and to predicting the extent and manner in which it might share in future community growth.

An important finding of this general office space analysis was that demand for office space on or about the Capitol Square is a submarket of the Madison office market which does not directly compete with outlying commercial nuclei. In arriving at this conclusion, tenants of major new office buildings in the suburbs were checked to determine their locations prior to moving into a new building since 1962.

A. Of 85 new tenants in Hilldale office buildings, 61 could be traced to 1960 addresses. About one-sixth of these came from the Square, but these 10 represent only 12% of the new tenants in the area. Moreover, several of these tenants from the Square have indicated an interest in moving bank to the Square area when their leases expire. A branch law office has not proven to be useful and a large insurance office finds the new ease in parking does not offset the loss of street intelligence from street and lunch room contacts in downtown Madison. (Appendix Table A).

B. Of 28 tenants checked in new office buildings on Atwood Avenue and in Monona Village, only one came from the Square area,- an insurance

office. Six were unlisted in 1960. Most of those tenants unlisted in 1960 were young doctors or dentists.

C. Of 8 new tenants in two buildings in the Northgate area on East Sherman Avenue, none came from the Square.

D. Conversations with officials of Wisconsin Bar Association and the Wisconsin State Medical Association indicated that there were few examples of professionals presently on the Square who would be better located in one suburb or another.

E. Of 77 physicians and surgeons now on the Square, 64 are identified in the Directory of Medical Specialists as concentrating their practice in a specialty. (Appendix Table B). Generally speaking, a specialist must be centrally located for referrals, where not solely a hospital staff physician. However, the new medical center in the Triangle redevelopment area will attract some of the doctors now on the Square.

F. Of those who did move to the suburbs, there were only two reasons for leaving the Square, which most did with regret. One reason was convenient parking for clients and the other reason was that the nature of their business required that they follow their market to the suburbs.

In years past, the State of Wisconsin has been an important user of privately owned office space in central Madison. The recent addition of a considerable amount of office space in State-constructed buildings and the large potential for the expansion of the University Hill Farms State office complex leads to the conclusion that for some

time to come, State demand is not to be counted on in estimating needs for privately-developed central office space. Conversations with State space officers indicate that the State would like to lease private space for the Tax Processing Center in the amount of 65,000 square feet, but indications are that this need will be met in the Triangle area or in the Hill Farm complex. There is a possible State requirement for privately-leased space for the Department of Public Instruction and for the Regents of the State colleges totalling 40,000 square feet. Central area locations are preferred for these facilities but the uncertainties of this demand are such that it is not counted on in our demand calculation. Such demand could well be offset by shifting State activities now in privately-leased space to public buildings.

As a basis for predicting office space demand in 1970, major reliance has been placed on employment predictions which have been prepared for the Madison Transportation Study by Mr. James Scott of the Madison Planning Department. These forecasts are based on population projections, an analysis of employment by geographic areas of the city, trends in land use patterns, extensive interviews with employers, and other basic planning information which is under constant study by the Planning Department. In making the employment projections, a standard and widely accepted system of classification has been followed. Within this classification, two categories have particular relevance to the demand for office space -- Finance (including insurance and real estate), and Services (except educational). It may properly be assumed that the demand for general office space by private activities will be

closely correlated with the expansion of the number of persons engaged in these two classes of activity. As will be explained in the following paragraphs, the key prediction is that which related to professional employment for the Madison community. Historical analysis demonstrates consistency in the proportion of total professional employment which is located in the Square area and in the ratio of total central office space which is occupied by professional offices. With adjustment in these relationships for observed trends, a prediction of overall office space needs can be derived.

The general employment projections prepared by Mr. Scott are summarized in Table 0-3. The predictions by geographic areas cover the Capitol Square, which includes the area within five blocks of the Square, the West side and the East side. The data indicate that while the Square area lags behind the City of Madison and the West side in percentage of growth for each of the three periods in terms of total employment increases, the 1962-1970 estimates show the Capitol Square area enjoying the best rate of growth in finance,[1] and service[2] employment compared with the other segments of the City. In the period 1951-1962, the Capitol Square area marked time while the West side commercial activity mushroomed, particularly in the area of services related to residential land use. Mr. Scott is of the opinion that equilibrium has returned and the Capitol Square area and the West side area will expand at about the same rate from 1962 to 1975.

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[1]This category includes insurance and real estate.

[2]This is service employment except educational.

The analysis of the numbers of professional people (Appendix Table C) on the Square indicates that only accountants and attorneys have increased in the number and proportion of their profession on the Square. Architectural offices require cheaper space and the major firms have their own office buildings scattered in the suburbs. Dentists have dispersed to the suburbs, the exodus beginning long before Hilldale. The percentage of total professionals in each field located on the Square has fallen each year, but in our opinion will stabilize at 50% of the community's professional force.

Table 0-4 summarizes the historical and projected relationships between total Madison employment in the Finance and Service categories and professional employment, and between professional employment in the community and that located in the Square area under the definition which includes two blocks on all sides.

On the basis of the forecast of 661 professional persons in the Square area in 1970, we can now proceed to estimate the space requirements for these professionals and to blow up this figure to the full office space needs.

As a first approach to the problem of space needs estimation, it is possible to establish a ratio between the Square space occupied by professionals in 1964 and the total occupied space of A, B and C quality classes at that time. There were 497 such professional persons and 326,000 square feet of all occupied space or a ratio of 656 square feet of occupied office space per professional person. If this same ratio were to obtain in 1970, the existence of 661 professional persons

would suggest the need for 433,616 square feet of general office space to accommodate all classes of tenant. The fact that there is a trend toward increasing space per office worker suggests that this approach may yield a conservative figure. A figure of 450,000 would seem more reasonable.

Another approach is based on current space use in professional offices which is of the order of 425 square feet per professional. On this assumption, the 1970 professional requirements would be 280,500 square feet and 466,000 square feet for all purposes (excluding government and owner-occupied space) if a ratio of 60% professional space to total office space were to obtain. Only an approximation of this ratio is possible from available data but the result is not inconsistent with the first estimate of 450,000 square feet. For working purposes, we are selecting a range from 425,000 to 475,000 square feet in demand as the basis for demand-supply analysis. This range allows for variation in the employment projections, and in vacancy ratios, and for error in the space-needs ratios employed in the calculation.

Demand-Supply Relationships

The ranges of estimates arrived at in the demand and supply analyses suggest that there will be no need for additional office construction in central Madison if the low demand figure and the high supply prediction are realized. On the other hand, some 75,000 square feet of space will be needed if the high demand and low supply figures are to obtain in 1970. It is a general conclusion, therefore, that no

oversupply of central office space is likely in 1970 in light of facts and factors now in view. It is a further extension of the estimates than an office building of moderate size in a good and competitive location at competitive rents could probably be economically justified. One fact which is hard to estimate as a safety factor is the propensity for tenants in older and less desirable space to move into the new and attractive space if rent differentials are not too great. Thus if there should be a moderate oversupply of office space in 1970, it is possible that the older buildings would suffer more than the new and attractive structures.

Office Building Location

Up to this point, the overall demand and supply situation in the central area has been the object of analysis. But it may be relevant to consider the comparative advantages of locating office space in the three locations which have been suggested as possibilities for the new banking house:

Site A - the present bank location

Site B - northwest corner of Pinckney and Mifflin Streets

Site C - triangle bounded by State, Mifflin and Fairchild Streets.

Site A is rated as best of the three choices. Its advantages lie in proximity to the State office building, the City-County building and the Federal building as important linkages for lawyers and many other types of activity. It is a satisfactory location of medical offices though with no special advantage. The public parking in the County ramp

and the City ramp to the east, soon to be expanded, is adequate for both employee and customer parking, though it is assumed that additional parking is to be provided on the site. The proximity of the Park Motor Inn is an advantage and adequate lunch facilities are conveniently situated. The location is sufficiently close to retail facilities to provide noon-hour and after-hour shopping opportunities for employees. It is more remote from the emerging 100% retail district at the head of State Street than the other two sites and thus not quite so advantageous from a customer standpoint in facilitating mutiple-goal downtown expeditions. The proximity of other office buildings -- Anchor, Bank of Madison, Tenney and Insurance Buildings is an added advantage from a linkage standpoint.

Site B is the least desirable as an office building site but is far from being disqualified. Its main relative advantage is proximity to the retail center and to present and proposed public and private parking facilities. The greatest disadvantage is remoteness from the City-County-State-Federal concentration.

Site C at the head of State Street occupies a middle position from the standpoint of office location. It is more nearly in the center of retail activities than Site B and is closer to more lunch rooms. It will be close to the new office buildings proposed for both sides of Carroll Street and the Square and to the First Federal building. It will be slightly closer to the civic center public office buildings than Site B. Parking facilities, public and private, should be adequate. It may be some advantage to be the closest to the University campus and student body.

The general conclusion is that any of the three sites would be satisfactory for office building use and that the favorable conclusions derived from the demand-supply analysis will not have to be effectively modified regardless of the site selected. On the other hand, the more favorable the location, the faster the rent-up, the better the rent level and the more protection against adversity.

Rents

The critical question with respect to rents is the rental schedule for the proposed new office space which will produce optimum effective gross income. By 1970 there will be a substantial increase in the proportion of all central office space which is Grade A. At the present time, Grade A space is commanding rents in the range from $4,50 to $5 per square foot. Our market analysis suggests that competitive pressures will not permit this level to rise and that $5 is the top figure which can be expected for the best and most completely serviced office space. This figure must include heat, light, hot water, air conditioning and complete janitorial service. Adequate parking at reasonable rates either in the building or in close proximity is absolutely essential.

Professional-condominium Office Accommodations

The national popularity of the tenure arrangement known as condominium has recently extended to office facilities. Both professionals and corporate entities have found advantages in the ownership of office space in a building in which public areas are maintained in common with other occupants. There are investment and tax advantages to be added to the virtues of assured occupancy and stabilized costs. There are

intimations of an interest in this kind of facility in Madison. It is therefore suggested that regardless of the location of the new office space, serious consideration be given to the development of office space which could be sold under the condominium arrangement. Such a scheme would have advantages to the Bank in assisting in financing the building, sharing of operating costs, freedom from management headaches and investment risks, and the possibilities of an entrepreneurial profit in the sale of the space.